

Testimony to the Labor and Public Employees Committee of the Connecticut General Assembly Supporting HB 5313: An Act Creating a Task Force to Study a State-Administered Pension Fund for Employees in the State

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Thank you to members of the Labor and Public Employees Committee for the opportunity to testify. I am Lauren Schmitz, a Research Analyst at the Bernard L. Schwartz Center for Economic Policy Analysis (SCEPA) at The New School in New York. Our work focuses on the public economics debate surrounding the role government can and should play to raise living standards and create economic security. Our director, Teresa Ghilarducci, is one of the nation's leading economists on retirement security and a highly visible advocate for pension reform. My testimony covers SCEPA's State Guaranteed Retirement Account (GRA) proposal that aims to expand retirement security at the state level by giving workers who currently lack access to a retirement plan through work the option to invest in a retirement plan administered by the state pension fund. This proposal is already being considered in the California legislature.

Traditionally, American retirement income has been based on a pyramid of layered income sources: the bedrock and the base of retirement income is Social Security, the middle-tier is employer-sponsored retirement plans, and at the top of the pyramid is personal savings. Each layer is a different size for every person—low-income workers have a much larger Social Security base and fewer personal assets than higher income workers. This metaphor makes it clear that although Social Security was designed to insure only a portion of a retiree's income, it in fact often makes up a majority of that income. However, its benefits average only \$1,177 a month, too little to ensure a decent standard of living; additional savings from other sources are necessary for a comfortable retirement.

For years, many workers have relied on employer-sponsored retirement plans to supplement Social Security in retirement. But the employer-sponsored retirement system is on the decline on several fronts; in fact, most private employers do not offer any type of retirement plan at all. Medium and small firms are least likely to sponsor any kind of plan¹ because retirement plans, like health insurance, are a voluntary expense, and because small firms have less revenue and managerial expertise to navigate regulations and administrative burden. As a result, employer sponsorship of retirement plans has declined nationally from 61% in 2000 to 53% in 2010.² In Connecticut, the downturn in sponsorship over this same time period has been from 64% to 58%.

Even if workers do have a retirement plan through their employer, these plans have shifted from defined benefit (DB) plans, where workers were guaranteed a set payment for life based on years of service and salary, to defined contribution (DC) or individual account 401k-type plans. DC plans shift all

the risks and costs of retirement onto the shoulders of workers: they charge exorbitant fees that eat away at returns³, require workers to choose from a bewildering and opaque menu of investment options, and may be exhausted before the end of a worker's life.

All workers, whether or not they are covered by a 401(k) style plan or an individual retirement account (IRA), need a financial institution that will administer their retirement savings in an efficient, low cost way that earns a secure and sufficient rate of return and preserves savings for retirement. The policy challenge, then, is not just to expand access to individual account-based retirement plans, but to address the critical failures in the existing system to meet three key criteria for retirement income security: 1) Adequate contributions; 2) Low-cost, quality investment vehicles that are professionally managed and, ideally, shield individual workers from investment and market risks; 3) A lifetime guaranteed stream of income at retirement.

In 2010, 686,425 workers in Connecticut between the ages of 25 and 64 did not have access to a retirement plan through their employer.⁴ We propose that the Connecticut legislature restore access by giving workers who currently lack a place to house their retirement savings the option of opening up an individual, cash balance pension plan through the existing Connecticut Retirement Plans and Trust Funds (CRPTF).

A cash balance plan is officially a defined benefit pension plan that has a hybrid structure. The contributions are pooled and the employer and/or employee put a defined percentage of pay into an account. The account receives a defined rate of return usually around 3%. The final benefit is determined by the account balance and can be converted into an annuity at retirement. We propose employees and employers contribute at least 5% of pay. Taking into account Social Security benefits, a 5% contribution rate with a real return of about 3% would allow a middle income worker to replace nearly 60% of their pre-retirement income.⁵

We have modeled the feasibility of a 3% guarantee and found using Monte Carol simulations⁶ that there has never been a 40-year period where a diversified portfolio earned an average annual real return of less than 3.5%. While we cannot guarantee the future, the past seems to indicate that the risk the state would bear in order to back this guarantee would be negligible. In addition, a Board of Trustees established to administer the plan would likely be given the authority to adjust the guarantee year to year to minimize any unnecessary risk. The Board would also take on any fiduciary responsibility to ensure that the retirement savings are managed in the beneficiaries' best interests.

The plan would contract with the state pension system to invest the funds. States, through their employee pension plans, already sponsor excellent financial institutions that, on a not-for-profit basis get the highest returns for the least cost. These funds pool the market and longevity risks of a large number of individuals, have the best money managers, and their bargaining power lowers Wall Street fees. The public pension fund traders are also more disciplined and have a longer-term view, which stabilizes markets and protects individuals from swings in asset prices. In short, because they pool

Every worker needs a safe and convenient way to save their earnings to prevent downward mobility in retirement. SCEPA's State GRA proposal would connect private sector workers to the public sector's secure and efficient pension funds to restore retirement income security for all workers.

¹See the Bureau of Labor Statistics National Compensation Survey, Employee Benefits in Private Industry for information on sponsorship by firm size: <http://www.bls.gov/news.release/ebs2.t01.htm>.

²Authors' calculations from the 2001 and 2011 Current Population Survey, March Supplement.

³Hiltonsmith, Robert. 2010. "The Failure of the 401k: How Individual Retirement Plans are a Costly Gamble for American Workers." New York: Dēmos.

⁴SCEPA's calculation from the March Current Population Survey. Data from 2010 are two year averages from 2010 and 2011. We include only workers with positive earnings between the ages of 25-64.

⁵Ghilarducci, Teresa. 2011. "High Performance Pensions for All Californians." In Nari Rhee, ed., Meeting California's Retirement Security Challenge. Berkeley, California: UC Berkeley Center for Labor Research and Education, pp. 94-112.

⁶Stubbs, David. 2010. "Modeling a Guaranteed Retirement Account System." SCEPA working paper. <http://www.economicpolicyresearch.org/working-papers/122-modelling-a-guaranteed-retirement-account-system-in-the-united-states.html>

⁷Almeida, Beth, and William B. Fornia. 2008. "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Plans." Washington, DC: National Institute on Retirement Security (NIRS).

⁸SCEPA's calculation from the March Current Population Survey. Data from 2010 are two year averages from 2010 and 2011. We include only workers with positive earnings between the ages of 25-64. Based on this sample, a 5% contribution of median income earnings (\$29,000) is multiplied by 686,425, or the number of workers who reported working for an employer who did not sponsor a retirement plan in 2010. This yields \$995,316,250 in savings.

⁹Lockyer, Bill. 2010. "California's Fiscal Future: Do We Need a Public Pension Reboot?" at the 21st Annual Northern California Public Retirement Seminar. October 13. Sacramento, CA <http://www.treasurer.ca.gov/news/releases/2011/20111013.pdf>